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After the summit . . . before the fall

by Chris White

Since March, the circles associated with former West German Chancellor Helmut Schmidt have been warning that the Bush adminstration had been given until the Paris summit of the Group of Seven heads of state to demonstrate that it could take serious action to reduce the U.S. budget deficit. After that, it was said, it would be a different matter.

It is now two weeks since the gathering in Paris which marked the falling due of the deadline delivered via the messenger Helmut Schmidt. On the American side, ignoring for a moment the scramble to pass legislation through Congress before the session ends Aug. 15, it is becoming increasingly clear that the action demanded by the creditor circles Schmidt represents will not happen, at least until the fiscal year that begins in October 1990. On the other side, it has also become clear that Schmidt's summit deadline was also a real one. The creditors of the biggest single debtor nation in the world do not seem prepared to extend another year or more of grace before enforcing their day of reckoning.

Three sets of developments point to that conclusion:

- the so-called, in Mexico at least, "breakthrough" debt agreement reached in round-the-clock negotiations over the weekend of July 23;
- the series of votes in the Congress against the administration's budget proposals, and S&L bailout plan; and
- warnings from the head of Japan's central Bank that he will have to increase interest rates to supposedly keep internal inflation under control.

The combination of each of the cited three cases indicates that at the level of those American creditors who deploy such agencies as the Basel, Switzerland-based Bank for International Settlements, the decision has been made, now that the Group of Seven summit is over, to begin to shift the world financial system away from the speculative methods associated with the so-called "creative" or "innovative" financial practices which underwrote what is still known as the "Reagan economic recovery," towards what the same circles call "traditional banking" or "traditional finance."

European financiers foresee crash

The shift casts into sharp relief the warnings issuing from top financial circles in Europe that the world is set on course for the eruption of a new series of financial shocks, perhaps in the month of August, when the vacation period quiet greatly magnifies the effect of relatively small-scale financial movements, if not then, in September, or in October. For such circles it is no longer a matter of whether there is going to be another round of financial turmoil, but when that turmoil will erupt. The changed pattern of activity by America's creditors, since the Paris summit, is good evidence that such turmoil will erupt sooner rather than later.

The whole is further complicated by the development of the internal Russian crisis into mass strike form, and by the demands posed on the West for delivery of consumer goods, in the order of $15 billion worth, to permit Gorbachov and company to deliver on concessions promised to end strike activity. Non-delivery is sure to exacerbate turmoil. Delivery on Gorbachov's terms, leaving aside the matter of physical possibility, will serve as final proof that the degeneration of Western leadership has gone so far as to perhaps be irreversible.

The so-called Mexican debt agreement is the best marker of the emerging shift against the speculative methods of "creative" finance. The U.S. adminstration team had made desperate efforts prior to the Paris summit to come up with a package that would provide the basis for a public relations triumph at the summit. The idea was that "an agreement in

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principle" would be concluded between Mexico and the group of bankers, led by Citibank, who represent the creditors. Such an agreement would have permitted the American delegation at the summit to tell other delegations of the significant progress that had been made. Shot down by the bankers, who added conditions unacceptable to Mexico in the days before the summit, this triumphalistic intent was doomed.

But an agreement was concluded in the week after the summit. New players entered the negotiations, and new so-called solutions were included as part of the package. Participants' tight-lipped responses to queries about what occurred indicate that at some point, America's creditors pulled their debtor's chain. Among the new players were the Bank for International Settlements, and the New York district of the Federal Reserve under its chairman Gerald Corrigan. Among the new so-called solutions: credit for debt repayment secured against long-term, fixed price delivery of hard commodities. The BIS is privately reported to have extended $2 billion in interim finance to underwrite the package which was concluded in round-the-clock, "no one leaves till we have an agreement" negotiations in New York. This $2 billion is on top of a similar $2 billion commitment for bridging finance by the United States.

With $4 billion committed at short notice, it is obvious indeed that someone, somewhere, is once again very much concerned about the possibilities of a debt blowout emerging again. Though participants in the talks stressed that both the New York Federal Reserve and the BIS had been involved in debt negotiations before, they were hard-pressed to cite examples of such participation, except during such moments as Mexico's near declaration of a debt moratorium in 1982, and Brazil's resumption of interest payments, after its moratorium ended in the last quarter of 1988.

The commodity agreement, though, indicates that plans are now being moved off the drawing board for the development of the fallback options in the event of financial collapse. Though small—rather more than $200 million in size—the long-term copper agreement, negotiated as part of the debt arrangement between a consortium of 11 banks headed by Paris-Bas and Mexico's copper company, Cobre Mexicana as supplier, and Belgium's Société Générale refining subsidiary as consumer, is described as "the wave of the future" by those responsible. The idea is that banking activity will begin to be tied back to hard commodity trade, whether in the form of industrial, agricultural, or fuel raw materials. Paper issued will be secured against the delivery of such hard commodities, on a long-term fixed price basis, with the banks mediating the supply of specific amounts of the product to specific end-users. This arrangement bypasses the entire speculative edifice which has been built upon the relationship between futures markets and spot and equity markets, through such means as the various kinds of options indices which have permitted speculation in equities markets, for example, to be hedged against futures markets. This edifice in turn has helped underwrite the growth of bank trading in the form of securitized paper known as "off-balance sheet liabilities." The commodity feature of the debt agreement represents the bankers' adoption of a fallback option against the increasing likelihood of a collapse in financial paper.

The agreement was made possible during the week before the debt agreement was signed, when Wendy Gramm at the Commodity Futures Trading Commission ruled that "commodity swaps" would not be subject to CFTC regulation, because such swaps are not equivalent to futures contracts. Unlike a futures contract to buy or sell a certain commodity by a certain date, which can be transferred into another futures contract, or realized as a physical trade in goods, the commodity swap is found to be an individually tailored transaction between a specific supplier and a specific consumer, mediated by a bank or group of banks, with a relatively long time frame, and a fixed price.

Such commodity swaps, along with currency and interest rate swaps, have been conducted outside the United States since a July 1987 ruling by the same CFTC that they did in fact constitute futures contracts. The reversal on this matter, like the Mexican debt talks themselves, is part of the pattern that indicates the pressure brought to bear on the United States. The CFTC's decision is to be taken together with a new round of attacks on the Chicago Board of Trade and Mercantile Exchange, in which the protagonists in the fight for control over July delivery soy beans, namely Cargill and Ferruzzi, are both questioning whether there is any purpose served in the Chicago market's continued existence. Instead of the Chicago futures markets it is estimated that the big commercial banks will preside over the growth of commodity swaps from a level of about $2 billion today, up to $100 billion plus.

The arrangement is traditional in more ways than one. It is essentially a commitment to revive 19th-century raw materials-based looting forms of imperialism. In this arrangement, supposed financial power disposes of raw materials control as a means of disposing the fates of producers and consumers alike. Since the paper is going to come down anyway, with or without such so-called returns to traditional methods, the new form of commodity-based agreement must be seen as an effort by the major banks to maintain their political power, through raw materials control, after the speculative paper mountain has been wiped out.

Here again we have a case of the arrogance which assumes that financial crashes, if they can't be avoided, can be directed and steered, to whomever's benefit. As usual, such thinking overlooks the reality that financial matters are not in and of themselves the be-all and end-all. The breakdown of the world economy's capacity to continue to support human existence feeds the aggravation of financial crises. So long as that is not dealt with, no so-called traditional financial methods will make any degree of difference worth a hill of beans.